BILL # SB 1073 | **TITLE:** standard tax deduction; inflation index

SPONSOR: Martin | **STATUS:** As Introduced

REQUESTED BY: Senate | **PREPARED BY:** Hans Olofsson

FISCAL ANALYSIS

Description

This bill would adjust the dollar amount of the standard deduction claimed by taxpayers each year to the average annual change in the Metropolitan Phoenix Consumer Price index.

Estimated Impact

This bill would result in an individual income tax revenue loss of $(2,488,500) million in FY 2005 and $(5,010,200) million in FY 2006 relative to current law.

The Department of Revenue (DOR) estimates the revenue impact to be $(1.7) million in FY 2005. The reason for the lower estimate is that DOR assumes a lower inflation rate. No estimate was provided by DOR for FY 2006.

Analysis

The U.S. Department of Labor Statistics (BLS) releases the Phoenix-Mesa Metropolitan Area Consumer Price Index (CPI) semi-annually. The last release was issued on August 15, 2003, which showed a year-over-year change in the index of 1.8%. In analyzing this bill, we have assumed that the same inflation rate (i.e., 1.8%) will hold for both calendar years 2004 and 2005.

Under current law, a single person or a married person filing separately can take an optional standard deduction of $4,050 each tax year. For a married couple filing a joint return or a single person filing as the head of a household, the corresponding amount is $8,100. Assuming that the Phoenix-Mesa CPI will grow by 1.8% in calendar years 2004 and 2005, as noted above, we determine the corresponding standard deduction amounts to be $4,123 for tax year 2004 and $4,197 for tax year 2005. (For married couples filing jointly and single persons filing as head of household, the standard deductions would equal $8,246 and $8,394 for tax year 2004 and 2005, respectively.)

DOR entered the inflation-adjusted standard deduction amounts, as projected by the JLBC Staff, into its individual income tax micro-simulation model and obtained a result that showed a revenue loss of $(2,488,500) for FY 2005 and $(5,010,200) for FY 2006. The JLBC Staff has no means to independently verify the accuracy of such estimates.

Note that DOR's model only measures the "static" or direct impact of the proposed legislation. In other words, DOR's model does not attempt to incorporate the potential behavioral response of taxpayers to tax law changes. For example, economic theory suggests that the lower taxable income that results from the increased standard deduction will raise households' disposable income, which in turn will increase the demand for goods and services. The increase in aggregate demand will result in increased economic activity (employment, investment, etc.) which over time will translate into more state tax revenues. While the JLBC Staff has not computed the "dynamic" or indirect impact of SB 1073 on state revenues, prior model simulations of similar proposals have shown a "feed-back" effect of 5%. This means that our model generally predicts that for each dollar released into the Arizona economy as a result of an individual income tax reduction, an additional 5¢ in General Fund revenues will be generated.

Local Government Impact

Each year incorporated cities and towns receive a percentage (15% in FY 2005 and FY 2006) of individual and corporate income tax collections from 2 years prior. Hence, the bill will reduce local government distributions by $(373,300) in FY 2007 and $(751,500) in FY 2008.

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